

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-125932-08

Date: November 19, 2008

### Legend:

X =

State =

D1 =

D2 =

A =

B =

Trust A =

Trust B =

D3 =

D4 =

D5 =

D6 =

Dear :

This responds to the letter dated June 5, 2008, and related correspondence, submitted on behalf of X, requesting relief under §1362(f) of the Internal Revenue Code (A Code) for an inadvertent invalid S corporation election and inadvertent termination of S corporation election.

### FACTS

The information submitted states that X was incorporated under the laws of State on D1. On D2, A and B, husband and wife, both shareholders of X, established Trust A and Trust B, grantor trusts under subpart E of part I of subchapter J of chapter 1 of the Code, respectively. On D3, A transferred all of his X stock to Trust A and B transferred all of her X stock to Trust B. On D4, A died and, thus, Trust A ceased to be a grantor trust.

Subsequently, X elected to be treated as an S corporation for federal tax purposes effective D5. For purposes of the election, however, B, the deemed owner of X stock held in Trust B, did not execute the Form 2553, Election by a Small Business Corporation, filed by X. Further, on D5, although the estate of A was the deemed owner of the X stock held in Trust A under § 1361(c)(2)(B)(ii), the executor, administrator, or any other fiduciary appointed by testamentary instrument or appointed by the court having jurisdiction over the administration of the estate of A did not execute the Form 2553 on behalf of the estate of A. Therefore, Trust B and the estate of A did not properly consent to X's election to be an S corporation. Accordingly, X's S election was ineffective as of D5.

In addition, although Trust A was no longer a grantor trust on D4, it qualified as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for a two-year period beginning on the day of A's death and ending on D6. On D6, Trust A continued to hold X stock. It is represented that, on D6, Trust A was eligible to elect to be an "electing small business trust" (ESBT), a permissible shareholder of an S corporation. X and its shareholders, however, were unaware of the need to make such an election. Therefore, the trustee of Trust A did not file an ESBT election on behalf of Trust A effective D6. Consequently, on D6, Trust A became an ineligible shareholder of X.

X and its shareholders represent that they did not intend for X's S election to be ineffective or terminate and the circumstances resulting in such ineffectiveness and termination were inadvertent. Further, X and its shareholders have filed federal income tax returns consistent with X's S corporation election. X and each person who was and is a shareholder of X on and after D5 agree to make such adjustments that the Secretary may require, consistent with the treatment of X as an S corporation.

### **LAW AND ANALYSIS**

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(c)(2)(A)(ii) provides that, for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, may be an S corporation shareholder, but only for the two year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(B)(ii) provides that, for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(ii), the estate of the deemed owner shall be treated as the shareholder.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if—

- (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,
- (ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(a)(1) provides that, except as provided in subsection (g), a small business corporation may elect to be an S corporation.

Section 1362(a)(2) provides that an election under §1362(a)(1) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(2)(iii) of the Income and Tax Regulations provides that, for purposes of an election under § 1362(a)(1), the consent of an estate must be made by an executor or administrator thereof, or by any other fiduciary appointed by testamentary instrument or appointed by the court having jurisdiction over the administration of the estate.

Section 1.1362-6(b)(2)(iv) provides that, for purposes of an election under § 1362(a)(1), in the case of a trust described in § 1361(c)(2)(A) (including a trust treated under § 1361(c)(2)(A) as a trust described in § 1361(c)(2)(A)(i) and excepting ESBT), only the person treated as the shareholder for purposes of § 1361(b)(1) must consent to the S corporation election.

Section 1362(d)(2)(A) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that X's S corporation election was ineffective for taxable year beginning D5. We further conclude that the ineffectiveness of X's S corporation election constituted an inadvertent invalid election within the meaning of § 1362(f).

In addition, assuming X's S corporation election was effective on D5, we conclude that the election would have terminated on D6, because X had an ineligible S corporation shareholder on D6. We further conclude that the termination of X's S corporation election on D6 would have constituted an inadvertent termination within the meaning of § 1362(f).

Accordingly, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D5 and thereafter, provided that, apart from the inadvertent termination on D6, X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is contingent on X and its shareholders treating X as having been an S corporation for the period beginning D5, and thereafter. This ruling is also contingent on the trustee of Trust A making a valid ESBT election, effective D6, with the appropriate service center within 60 days of this letter. Provided that this ESBT election is made, from D6 and thereafter, Trust A will be treated as an ESBT effective D6. A copy of this letter should be attached to the election. In addition, this ruling is contingent on Trust A and its beneficiaries treating Trust A as an ESBT from D6 and thereafter. Trust A and its beneficiaries must file amended returns within 60 days of this letter to reflect any adjustments as a result of the ESBT election. If these conditions are not met, then this ruling is null and void.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code, including whether X was otherwise eligible to be an S corporation, or whether Trust A was otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to your authorized representative.

Sincerely,

*Dianna K. Miosi*

Dianna K. Miosi  
Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter  
Copy for § 6110 purposes